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June 28, 1996

VIA FEDERAL EXPRESS

Docket Control
ARIZONA CORPORATION COMMISSION
1200 West Washington
Phoenix, AZ 85007

RE: Tucson Electric Power Company's Comments on Electric Restructuring
Docket No. U-0000-94-165

To Whom It May Concern:

Enclosed are an original and ten copies of the above-referenced document for filing. Please date stamp the extra copy of the Notice of Filing and return to me in the attached stamped, pre-addressed envelope.

If you have any questions, please do not hesitate to call me at 520/884-3937.

Sincerely,

Sandra Waters

Sandra Waters
Legal Secretary

Enclosures

BEFORE THE ARIZONA CORPORATION COMMISSION

RENZ D. JENNINGS
Chairman
MARCIA WEEKS
Commissioner
CARL J. KUNASEK
Commissioner

IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.

DOCKET NO. U-0000-94-165

NOTICE OF FILING

Tucson Electric Power Company hereby submits its responses to the Commission's Request for Comments on Electric Industry Restructuring.

RESPECTFULLY SUBMITTED this 28th day of June, 1996.

TUCSON ELECTRIC POWER COMPANY

By: _____

Bradley S. Carroll, Attorney
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Original and ten copies of the foregoing sent via Federal Express this 28th day of June, 1996 to:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

Copies of the foregoing sent via Federal Express this 28th day of June, 1996 to:

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By: Sandra Waters
Sandra Waters
Legal Secretary

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IN THE MATTER OF THE COMPETITION IN THE PROVISION OF ELECTRIC SERVICES THROUGHOUT THE STATE OF ARIZONA.	DOCKET NO. U-0000-94-165

RESPONSES TO QUESTIONS REGARDING ELECTRIC INDUSTRY RESTRUCTURING

On Behalf of

TUCSON ELECTRIC POWER COMPANY

June 28, 1996

Introduction

The electric utility industry is changing rapidly and Tucson Electric Power Company ("TEP") is pleased to have the opportunity to help define the restructuring in Arizona. TEP believes that as the industry changes, so must the regulatory process. Such changes in regulation must promote long-term stability and efficient competition in order to provide benefits to all parties to the process.

Overall, TEP favors competition and believes a competitive electric utility industry is inevitable. Changing regulatory policy could require legislative action and there are a number of legal questions that the Commission will need to address. TEP also understands that several significant issues must be resolved prior to the opening of competitive electric markets including the following:

1. Creating a structure in which all energy providers can compete equitably;
2. Defining and developing an equitable recovery mechanism for stranded costs;
3. Determining the appropriate industry structure; and
4. Other important considerations.

1. Equitable Competition

One of the biggest issues the Commission must consider is how to ensure that regulated electric utilities are not disadvantaged relative to public power and other competing suppliers. Although ensuring equitable competition will be difficult, it is necessary to make certain that the competitive environment in Arizona encourages proper economic choices. The anticipated outcome of competition is increased economic efficiency resulting in lower prices for all consumers. All players in the market, which include Commission regulated entities, independent suppliers (power marketers, IPPs, etc.) and public power entities, must have equal access to customers and must play by the same rules. Questions A1 through A3 discuss the "level playing field" issues and what the Commission needs to consider before full competition can be implemented.

2. Stranded Investment

One of the major issues created by a change from a regulated to a competitive environment is the recovery of investments made under the regulated environment. TEP believes that utilities should be permitted full recovery of prudent investments made under traditional regulation. Assuring the recovery of these past investments will accelerate the transition to full competition by eliminating legal disputes between customers, electric suppliers and public commissions. Utilities should be given a reasonable opportunity to recover the value of designated assets within a reasonable time. Question A9 considers the issues surrounding stranded costs.

3. Industry Structure

There are several options available to the Commission concerning the appropriate industry structure. Many states across the country are investigating the same issue. California has produced the most aggressive plan by requiring divestiture, creating an Independent System Operator ("ISO") and Power Exchange ("PE") and allowing customer choice by 1998. Other options include corporate functional unbundling, holding company structures and implementing changes in the current regulatory process with minimal structural changes. TEP recommends investigating all options in considering what is the best structure for Arizona. Perhaps a progression of change would lead to full divestiture and the creation of separate entities for generation, transmission and distribution.

4. Other Issues

Many other issues must also be resolved prior to changing from a regulated to a competitive industry including the following:

- Identifying competitive and monopoly products and services;
- Developing the proper regulatory framework for monopoly products; and
- Determining the most efficient administration of social and environmental programs.

TEP recommends that additional workshops or study groups be formed to address the above issues, followed by public hearings. There are important economic theories such as contestable market theory and fairness verses efficiency theories that will help to properly define competitive and monopoly products. The Commission needs to consider alternative regulation mechanisms for monopoly products. Additionally, funding requirements for the currently mandated social and environmental programs need to be reviewed.

There are many ways to achieve the objectives identified in the Commission's October 5, 1995 Report. However, to achieve the desired results, it is important that the parties involved in the restructuring process take time to establish the correct incentives to move towards a competitive environment.

A1. Affected Utilities. *Which utilities should open their markets to competition?*

As stated in the Introduction, TEP believes that a truly competitive market requires participation by all potential power suppliers and distribution entities in the State. TEP supports the introduction of competition into the generation segment of the electric supply business, so long as it is done in a fair, reasonable and balanced manner. An efficient competitive environment requires that competitors operate under the same rules. The current regulatory structure in Arizona does not require this. Therefore, the Commission should implement policy changes and recommend the legislative changes that will level the playing field among the potential electric service competitors.

As a result of certain financial and regulatory advantages, public power entities have different cost and pricing structures than investor-owned utilities. These advantages include exemptions from price and other regulation by the Commission, exemption from state and federal income taxes, lower rates for other taxes, lower financing costs and preferred access to low-cost federal power. If such preference entities are allowed to retain these advantages and are not required to open their own markets to competition, then such entities should not be allowed to compete for the customers of other entities, either directly or indirectly.

Equitable competitive positions for production and delivery can be achieved either by removing some of the existing rules and obligations placed on investor-owned utilities or by mitigating the special advantages that public power entities maintain. The tax and preference power issues connected with public power entities are of particular importance if such entities are allowed to compete for TEP's existing customers.

The Federal Energy Regulatory Commission ("FERC") is requiring all transmission owning utilities, including non-jurisdictional utilities, to comply with their Open Access Final Rule ("Order 888"). Compliance with Order 888 should help level the playing field for wholesale markets. Additionally, many of Arizona's publicly-owned utilities are participating in Regional Transmission Groups ("RTGs") which require open access transmission. Both FERC and the RTGs require reciprocity, but it is uncertain whether the State can require the same type of reciprocity for retail competition. For example, if a company wants to compete outside its traditional territory for customers, other suppliers should be allowed to compete for its customers. Although publicly-owned utilities and municipals are technically not subject to the Commission's jurisdiction, the Commission should require reciprocity if non-jurisdictional entities participate in the energy marketplace.

In order to ensure that the competitive environment creates proper incentives to suppliers, distribution companies and customers, all customers must have reasonable and efficient access to competing power supply options. This includes all customers in the State; those served by investor-owned utilities, government-run agencies, cooperatives and municipal power suppliers. Unless all customers have a choice of suppliers and all suppliers are subject to the same rules, many customers and suppliers will be harmed by a competitive electric market, while a few would benefit significantly.

A2. Scope of Restructuring.

a. How much of the utilities' markets should be opened to competition?

See response to Question A2.b.

b. Which consumers should be allowed to shop around for power and energy? Consider both geographic areas and consumer classes.

Once a level playing field is established and mechanisms allowing utilities to recover prudently incurred investments have started, customers should have the option to purchase competitive services from their choice of suppliers. Services that exhibit natural monopoly characteristics should continue to be provided by existing jurisdictional suppliers and remain regulated. This structure is similar to the current telephone industry where non-competitive or essential services are regulated and competitive or non-essential services are not regulated.

Competition could be introduced through a phase-in or pilot program for small segments of each customer class. This process would give all customer groups, suppliers and the Commission an opportunity to develop the appropriate methods needed to obtain the benefits of competition, while maintaining a safe, reliable supply of electric service. Many issues must be addressed to ensure a reliable electric supply in a competitive environment. For example, operation of the electric system will change and customers will need to be educated as to their supply options. Additionally, internal systems will need to be developed in order to track usage and properly bill customers taking different types of services from different providers.

c. Should utility customers served under existing contracts be eligible to participate in the competitive market prior to expiration of the existing contracts?

TEP believes that existing customer obligations must be fulfilled. Otherwise, the potential cost of stranded investment for all other customers may be higher. Many of the special contracts were designed to provide incentives to keep customers on the

utility's system under terms that were reasonable to the parties at the time the contract was signed. If these contract customers are allowed to participate in the competitive process, they should only be allowed to do so for loads above those contemplated in the contract unless the customer compensates the utility for any stranded investment associated with their contract. When the term of the contract expires, or the customer compensates the utility for the contract value, these customers may enter the competitive market to the extent allowed under a phase-in or pilot program.

d. If divestiture were undertaken, how should it be accomplished?

TEP believes that divestiture will occur in the industry as a consequence of local, regional and national market forces. In an efficient market, companies will separate into generation, transmission and distribution entities when it is in the best interest of all stakeholders. If and when this occurs, the Commission will play a key role in the process. On the other hand, a Commission mandated divestiture process would inevitably be subject to a prolonged challenge by various constituents, impeding progress towards retail competition.

TEP believes that corporate functional unbundling is a reasonable alternative to divestiture. Functional unbundling of generation, transmission and distribution through the formation of corporate business units is currently sufficient to create the desired market efficiencies. The FERC is requiring functional unbundling of transmission and wholesale power operations by November 1, 1996 under Order 888. This will provide a test for the effectiveness of functional unbundling.

TEP continues to believe that the holding company structure is the best structure for the changing utility industry. In a holding company structure, a subsidiary's products are not simultaneously regulated and unregulated, as is the case today. It also provides legal and financial separation between subsidiaries engaged in different activities and protects the customers of the monopoly services. For instance,

a generation subsidiary of a holding company would be free to invest in a range of energy resources with diversified risk factors without harming retail customers.

A3. Term of Restructuring.

a. When should competition start?

Retail competition should begin as soon as the essential elements discussed in the Introduction are developed and policies and legislative changes are in place to ensure fairness in the competitive markets. However, while the Commission and concerned parties are determining solutions to key issues, a phase-in or pilot program could be implemented to allow the start of competition. Either program would allow the transition to competition to begin and provide a "laboratory" for developments to solutions of key issues.

TEP would consider a phase-in plan or a pilot program to initiate competition in Arizona. Both plans have positive aspects. A phase-in plan signals a stronger change from traditional regulation since it implies a "no-return-to-regulation" policy. A pilot program would allow customers and suppliers some experience before committing to a specific competitive structure. However, a pilot program will not necessarily test true market conditions because the majority of the marketplace will remain regulated, limiting true competition during the pilot. Under either plan, recovery of potential stranded investment must be ensured.

Given recent actions by the FERC, there is a need to evaluate how federal changes are going to affect the competitive retail markets in Arizona. Although the FERC did not order the development of an ISO or a PE, regional utilities may ultimately decide that an ISO is in their best interest. Consideration of the need for an ISO in response to Order 888 will provide significant insight into the restructuring process.

b. If competition is in the form of a pilot or phase-in, how long should the pilot or phases run? Please describe the phases of a phase-in. Please consider that many larger customers of utilities are currently under contract and may not be able to shop around until those contracts expire.

Any program needs to be long enough to work out potential problems. A three-to-five year program should be long enough to look at details such as reliability, power supply coordination, metering, customer service and other issues.

c. If competition is in the form of a pilot, how can the term of the pilot be set so as to avoid discouraging long-term contracts signed under the pilot?

No response.

A4. Services Available on a Competitive Basis. *Which services should be available in a competitive market?*

- *Distributed energy services at market based rates (serving multiple consumers located in proximity, and not requiring transmission service from others); this is distinct from on-site self generation for just one consumer.*
- *Central station generation services at market based rates (generation serving one or more consumers located at a distance from consumers and requiring transmission service).*
- *Other services described in section A5, A6, A7, and A8.*
- *Other services (please describe).*

Certain distribution services should be classified as monopoly services. For example, construction, operation and maintenance of the local distribution system and delivery of power to customers may meet the definition of monopoly services and should thus be provided by a distribution entity that is regulated by the Commission. However, certain other distribution services such as engineering studies, facility maintenance, wiring, HVAC

support, and others do not appear to have monopoly characteristics and should be provided competitively. Such services should be unbundled from the standard distribution charge allowing customers to choose services they wish to receive. TEP has not specifically identified monopolistic and competitive distribution services. We recommend the Commission sponsor workshops or other meetings to develop a clear definition of potential competitive and monopoly services to help facilitate pricing mechanisms.

Two other issues that need to be addressed are how competitive and monopoly service offerings affect revenue requirements and future rate hearings. Cost allocation will become a major issue in any rate case for remaining monopoly services. It will also be necessary to provide unbundled rates so that customers will have choices for their services. In accordance with its latest rate settlement, later this year TEP will provide distribution rates and considers this process the first phase of unbundling rates and services.

A5. Necessary Services. *Utilities and perhaps other parties will have to address the services listed below. Please indicate how these services should be offered, measured (metered), and priced on an unbundled basis.*

Services: Distribution service, transmission service, supplemental generation service, imbalance service (including accounting for losses), back-up (standby) service, voltage control, other ancillary services necessary for maintaining system reliability, scheduling of supplies and demands, repairs/consumer complaints, other necessary services -- please describe.

Many of the services listed above are being offered through Order 888 as ancillary services. Therefore, if a retail customer purchases from another supplier, these services will be available. The immediate need for unbundling rates is to analyze the distribution cost structure and develop prices for each service currently provided in bundled rates. Electric suppliers will have to develop internal cost systems that will break costs down by service.

New services will be identified through competition. In particular, services beyond the meter will become part of the competitive world. Some service offerings that may be bolstered by competition include equipment installation and maintenance for customers, telecommunication services, home security and engineering design. Additional services are likely to develop in the competitive environment. We recommend the Commission sponsor workshops or other meetings to look at unbundling rates.

A6. Market Center Services. *The market may benefit from the services listed below. Please indicate how these services should be offered and priced.*

Services: title transfer, transaction confirmation, establishing credit standards, invoicing, dispatching of transmission/generation, exchanges/swaps, interruption notification, imbalance trades.

Most of these services are currently performed by each individual utility. In the future, these services may become more centralized through the formation of an ISO or some similar type of organization (see response to Question A12).

An entity will have to be responsible for the reliable delivery of power. The distribution company could take this responsibility as one of its monopoly services or customers and generation suppliers could be required to ensure that reliability concerns are dealt with. TEP believes that the suppliers of competitive services should be required to ensure that they are delivering the products that they promise. Assurance that these requirements are met must be controlled by a third party such as an ISO or some other oversight group that has the ability to penalize suppliers that do not meet their obligations and to require such suppliers to pay for damages created by their failure to meet supply requirements.

Regulated distribution suppliers should be responsible for assuring the reliable distribution of power to customers. The responsibility for forecasting, planning, financing, constructing, operating and maintaining the supply of wholesale power will be assumed by

entities in the competitive marketplace. The ISO could undertake the responsibility for long-range demand and energy forecasting, which combined with the price signals from the marketplace, would be two of the key pieces of information needed by wholesale suppliers to make their decisions regarding the need for new facilities. The effectiveness of this process as it relates to the reliability of supply, will be tested in California and other states.

In addition to reliability issues, an open and competitive market is likely to introduce innovative new services. It is difficult to establish how such services may be offered and priced. Any structure developed to foster a more competitive electric supply environment should encourage new product development while providing safeguards to ensure that such new product offerings comply with reliability requirements and do not infringe upon any regulatory structures that may remain.

A7. ***Spot Market Services.*** *The market may benefit from the services listed below. Please indicate how these services should be offered and priced.*

Services: electronic bulletin boards for spot transactions/prices, power pooling services, coordination with futures/options markets.

See responses to Questions A5 and A6.

A8. ***Transmission Service.*** *For a competitive market to work, utilities owning transmission facilities must provide transmission service. Please indicate how the following objectives would be met:*

- *Services must be provided consistent with FERC tariffs.*
- *Utilities must accept power delivered to their transmission systems by other suppliers and offer wheeling services comparable to services they provide to themselves.*
- *All sellers supplying consumers must have interconnection agreements with owners of necessary transmission facilities.*

Bulk transmission requirements of generators furnishing power to wholesale customers are provided pursuant to FERC rules. The FERC's recent ruling on open access transmission will govern the use of all interstate transmission facilities. This rule requires all regulated utilities owning transmission to file open access transmission tariffs which offer services on terms comparable to the transmitters own use. Therefore, to the extent that retail customers become wholesale customers for generation services, the objectives of this question are met by compliance with Order 888.

A9. Recovery of Stranded Investment. *Please indicate how the recovery (if any) of stranded investment should be accomplished. Address each of the following issues:*

a. The definition of stranded investment.

Stranded investment recovery is one of the major issues that must be dealt with as the industry moves to a more competitive market. Stranded investment represents:

> *an aggregation of costs incurred for the provision of utility service under the obligation to serve in a regulatory framework, that are likely unrecoverable in a competitive market due to market prices that are below embedded costs.*

Stranded investment consists of: (1) generating facilities for which revenue requirements exceed the annual levels likely to be collected in a competitive environment; (2) above-market purchased power obligations and (3) regulatory assets (recorded and unrecorded). Regulatory assets are created as a result of regulatory decisions that defer specific costs for future recovery.

b. The fraction of stranded investment which should be recovered.

See response to Question A9.e.

c. How the Commission will determine the amount of stranded investment, taking into account: revenues under traditional tariffed rates (or

existing special contracts); actual utility revenues from customers who obtain discounted rates or obtain service from others; increases in net revenues from wholesale sales and additional retail sales, including the effects of price elasticity of demand; increases in the value of assets due to new pricing or competition; mitigation of stranded investment; and other relevant factors.

See response to Question A9.e.

d. Preliminary estimates of the magnitude of stranded investment (please provide supporting analyses).

See response to Question A9.e.

e. The proper ratemaking treatment of negative stranded investment.

In a competitive power market, utilities may be unable to fully recover the remaining costs of prior investments. Such costs are not new; rather they are costs incurred under the existing regulatory structure which have not been recovered to date as a result of regulated pricing mechanisms. Ultimately, an alternative recovery mechanism must be created. Consistent with the assurances and obligations that have existed under the traditional regulatory compact, a stranded cost mechanism should be established before the transition to competition is started. Legally, the prudence of such costs has already been established in prior regulatory proceedings.

The most significant variable in computing stranded costs is the market price for power. Other factors include:

- Cost and mix of generation fuel;
- Interest rates and inflation;
- Developments in technology;
- New generation;
- Market structure and capacity;
- Customer demand; and
- New laws and regulation.

Given the volatility associated with the factors required to determine stranded costs, TEP advocates a periodic recalculation, refinement and updating of the calculation. TEP also favors some form of periodic true-up mechanism or other re-evaluation process.

The amount of each utilities stranded investment will become clear after a standard definition is developed through a cooperative effort involving utilities, customers and the Commission. TEP is investigating various methodologies for evaluating stranded costs and hopes to work with the Commission on this important issue.

f. From whom stranded investment should be recovered.

See response to Question A9.g.

g. The mechanism for recovery of stranded investment.

One method for allocating stranded investment to customers is to require those customers that procure all or part of their energy service from alternative suppliers to provide compensation for their portion of stranded investment. This is the method established by the FERC for recovering wholesale stranded costs. Direct assignment of stranded investment to departing customers requires case-by-case computation of allocable costs. Case-by-case determinations are likely to be difficult to administer and will be subject to significant disagreement.

A more equitable and perhaps less controversial approach for retail stranded costs may be an across-the-board "wires" charge. This type of charge is also likely to be much easier to administer. TEP suggests that all customers pay for stranded investment through a specific line item on their distribution bill. The wires charge for all customers should be determined in an open regulatory process eliminating potential disagreements with individual customers and providing a forum for equitable distribution of stranded investment costs. The philosophy of spreading costs across-the-board in connection with the change of an industry from one

characterized by regulated, vertically-integrated monopolies to one of competitive market participants can be seen in the methodology adopted by the Federal Communications Commission for recovering the costs applicable to the interstate portion of non-traffic sensitive plant investment by local exchange carriers. As a result, every residential customer connected to the public telephone network pays a $3.50/month end-user fee, regardless of whether they make any long distance calls.

h. The time period over which stranded investment is to be recovered.

The method for stranded investment cost recovery should be decided before a move to competition starts. With respect to the proper time period for recovery, a one-size-fits-all approach may not be appropriate. The period of recovery should allow ample opportunity to recover stranded costs while considering the impact on customers.

i. How utilities can mitigate stranded investment.

Utilities should be provided incentives to reduce their stranded investment exposure through the regulatory process. Mitigation can be accomplished by:

- Continued aggressive cost containment and efficiency improvements;
- Adjustments to depreciation schedules;
- Rate freezes;
- Selling in new markets; and
- Timely recovery of regulatory assets.

A10. Recover of Costs of Commission-Mandated Utility Low Income, DSM, Environmental, Renewables, and Nuclear Power Plant Decommissioning Programs ("Mandated Programs").

a. How shall costs of mandated programs be recovered from participants in the competitive market?

Decommissioning

No response.

Low income and environmental programs

Under the current regulatory compact, utilities are obligated to administer and support various social programs in order to assure that all customers receive electricity at affordable rates. These programs are currently included in customers' bundled electric rates. In a competitive environment, costs for these programs should be the responsibility of all customers rather than the current practice in which utilities are responsible for costs directly and customers indirectly. TEP believes that these programs are beneficial to society and should continue, but that funding for the programs should be specifically identified and paid for by all electric customers.

TEP believes that the easiest option available for funding social and environmental programs is to apply a State-wide customer or wires charge which would be approved by the Commission. By requiring all customers to pay for these programs, regardless of which electric supplier provides their services, the Commission could level the playing field regarding social programs. In addition, costs would be evenly spread over a large number of customers and the results would have a minimum impact on rates.

DSM

DSM should be a self sustaining, for-profit and value added service. DSM programs could be part of the competitive distribution services market mentioned in question A4. If a customer values DSM and conservation, the customer should be willing to purchase services without subsidization and suppliers should be willing to offer such services in exchange for profit. DSM programs should provide customers with choices, flexibility, visible prices and the ability to decide whether to consume or conserve. Until DSM programs are self sustaining, programs could be funded

through the same wires charge mentioned above for a certain time period. Low income DSM programs should be funded with an across the board wires charge.

b. How shall the magnitude of the costs of mandated programs be determined?

No response.

A11. Encouragement of Renewables.

a. How shall renewables be encouraged in a competitive environment? Please discuss such mechanisms as a requirement that x percent of energy sold in the competitive market must come from solar resources.

See response to A11.c.

b. How could progress in encouraging renewables be measured?

See response to A11.c.

c. How could a renewables program be enforced by the Commission?

Like other general programs, renewable energy should be funded through a general wires charge to all customers until it is economically self sustaining. Ideally, renewable research programs should be developed so that the Commission does not have to enforce or mandate renewable projects. Providing customer incentives for use of renewable energy sources would foster new product development. Ultimately, renewable resources will have to be economically viable in order to thrive in a competitive environment.

A12. Pooling of Generation and Centralized Dispatch of Generation or Transmission.

a. Should pooling of generation or centralized dispatch of generation or transmission be mandatory or voluntary?

This is a difficult question to answer without a tighter definition of the pool or centralized dispatch. If the Commission sponsors generation pooling, the physical delivery of the pool should be mandatory, whereas the financial components of the pooling arrangement could be either mandatory or voluntary. A volunteer pool for physical delivery would not achieve the desired result of economic dispatch and lower generation prices. An independent agent such as an ISO should have the authority to enforce reliable operation of generation and delivery. The financial component of the pooling arrangement could be controlled by a PE. The PE should allow participants the flexibility to sell or purchase power from the pool or through bilateral contracts. The goal is to match the participants' specific situation and risk criteria. For example, a risk averse seller could choose to enter into bilateral contracts for the entire output of its production, whereas another seller could submit bids to the pool for its entire production, or procure its needs through a combination of contracts and bids to the pool. The ISO and the PE, could be combined into one entity or separated. For simplicity and efficiency, TEP prefers the single entity approach.

b. What technical requirements will be necessary to ensure reliable and efficient use of generation and transmission resources? Please propose specific requirements, if possible.

The specific technical requirements of the ISO will, of course, depend on the exact nature of the ISO, but the ISO must have the responsibility and authority to declare and enforce unavoidable rules that all participants adhere to. (See response to

A6.) These responsibilities will include procedures for reliable operation, including operating and spinning reserves, load following, dispatch of generation, scheduling of transmission, metering, and procedures for scheduling load and generation.

As to the adequacy and reliability of wholesale power decisions regarding the installation of new power supplies, these decisions are to be the responsibility of the marketplace. New bulk power transmission facilities may be required to deliver the output of new production plants. The Western Systems Coordinating Council ("WSCC") has practices and procedures in place for rating new facilities as well as for their basic design and operation so as to avoid jeopardizing the reliability of the bulk power networks. However, the competitive marketplace may not provide the incentives for those transmission facilities needed to reinforce the network in the absence of which generation may be constrained and bulk power transmission reliability reduced.

A13. Non-Public Service Corporations. *How shall non-public service corporations such as municipal utilities be involved in a competitive market? For example, the service territories of Arizona utilities not regulated by the Commission may not be open to competition and Arizona utilities not regulated by the Commission may not be able to compete for sales in the service territories of the utilities identified in Section A1. Alternatively, an Arizona utility not regulated by the Commission may voluntarily participate in a competitive program if it makes its service territory available to competing sellers and if it agrees to all of the requirements of the Commission's competitive program.*

Please see response to Question A1 for discussion on Non-Public service corporations.

A14. Conditions for Returning to Utility Service After the Conclusion of a Pilot Program. *If a pilot were adopted, please indicate what conditions are appropriate for returning to utility service after the conclusion of the pilot.*

See response to Question A15.

A15. Conditions for Returning to Utility Service. *Please indicate what conditions (if any) are appropriate for returning to utility service if a competitive market is on-going.*

If customers are allowed to choose suppliers for competitive services in the future, the obligation on the part of the host utility to provide such services should be eliminated. In a competitive marketplace a utility's "obligation to serve" should be replaced with the "obligation to connect." Under traditional regulation, the host utility has the obligation to serve all customers in exchange for a determined and protected service territory. In a competitive market, services deemed to be subject to competitive supply should be supplied solely by the market with no residual guarantee by any supplier except for reliability standards. Otherwise, "cherry-picking" of high load factor customers is likely to occur and customers with less attractive load profiles will be harmed by competition.

TEP feels that a returning customer should be required to reimburse the host utility for any costs associated with the re-establishment of electric service. Examples of such costs include fees to install new metering or other equipment, restoring billing and other relevant customer data on the Customer Information System. In addition, a returning customer would need to give the host utility adequate notice to secure resources if needed.

A16. Administrative Requirements.

a. A utility may require consumers obtaining generation from another entity to adhere to reasonable scheduling notification requirements, accept reasonable delivery points, adhere to reasonable metering requirements, and accept reasonable remote control requirements for

interruptions or other purposes. Please specify what you consider to be reasonable.

Reasonable requests for power receipt and delivery are already in place in the electric industry. The Commission should reference generally accepted regional practices rather than dictate new requirements. The North American Electric Reliability Council ("NERC"), WSCC, and others provide rules for the reliable operation of electric systems. The Commission should defer to these groups for guidance on acceptable operating practices.

b. How should the utilities identified in Section A1 notify their customers of the adoption of a competitive program by the Commission?

No response.

A17. Impacts on Other Utility Customers. *Please indicate how adverse impacts on rates or service of quality for utility customers not participating in the competitive market could be minimized.*

Adverse impacts on rates or service quality for utility customers not participating in the competitive market can be minimized by an effective, efficient, and equitable transition to competition. Customers not participating in the competitive market should be no worse off, at the minimum, than they are today.

In order to establish a smooth transition to competition, there must be clearly defined goals, timetables, and procedures in place to assure that:

- The process is orderly and efficient;
- That there is a level playing field for all participants in competitive markets;
- Stranded costs are handled fairly; and
- All major customer groups, including residential, receive the benefits of competition.

The role of the regulator should be to ensure that transmission access and distribution service is provided in an open, non-discriminatory manner, that there does not exist an unfair

concentration of power and transaction capability and that monopoly services are equitably priced. Performance Based Ratemaking or other incentive regulation should be considered as a means to ensure service quality for those customers not participating in the competitive market and for those services that remain under the Commission's jurisdiction.

A18. Reporting Requirements for All Sellers of Electricity to End Users. *Please indicate what reporting requirements (to the Commission) are appropriate and who should file reports.*

Reporting requirements should be the same for all energy providers in the State. Again, the emphasis should be on creating a level playing field. TEP supports continued reporting requirements for monopoly services which remain regulated but does not believe such reporting requirements are reasonable for competitive services. Some reports that regulated utilities are currently filing contain confidential or commercially sensitive data that the Commission should not reveal to the public. The Commission Staff should also consider reviewing its current reporting requirements and changing those requirements if necessary. Some data may no longer be necessary, while other data may become more important as the industry evolves.

A19. Certificates of Convenience and Necessity. *Please comment on whether competitive sellers who supply electricity to an end user must obtain a Certificate of Convenience and Necessity from the Commission (unless the seller already has an applicable Certificate). Please describe whether any conditions on the certificate would be necessary.*

Competitive sellers who supply electricity to end users should be required to obtain a Certificate of Convenience and Necessity ("CC&N") from the Commission. Although the CC&N would not provide a monopoly service territory, it would serve as a Commission issued license to provide electricity to end users, thereby subjecting the licensee to all

applicable statutes and regulations. The filing requirements for a CC&N should be similar to those set forth in A.A.C. R14-2-1002 for Alternative Operator Services.

The requirement of a CC&N is important for four reasons. First, it will allow the Commission to examine each seller. Second, it will provide regulatory oversight to ensure reliable service, as well as provide a forum for customer complaints. Third, a CC&N would level the playing field by requiring those entities not currently subject to Commission jurisdiction to subject themselves to Commission jurisdiction. Fourth, the CC&N process would allow regulators to prevent any adverse societal or environmental impacts within the State. The Commission could require reciprocity and some degree of regulation if a company wants to sell in what was another utility's exclusive service territory.

Conclusion

TEP believes that the Commission and the utilities must work together to ensure that the transition to full competition maximizes the benefits to customers without unduly harming the utilities and their shareholders. To this end, the parties must first resolve some of the major issues to create an atmosphere where all energy providers can compete equitably. This includes developing an equitable recovery mechanism for stranded investments, resolving the public power issue and determining appropriate industry structure. Until these issues are resolved, it will not be possible to create an equitable and efficient marketplace.

Although the Commission has held workshops, and we encourage that more workshops be held to discuss the comments filed in this Docket, it should consider holding public hearings on the major issues. Legislative issues should also be identified as it does not appear that the Commission will have all the necessary authority to create a fully equitable and efficient marketplace without legislative changes. Finally, the Commission should start working with each electric utility in the interim to discuss the tools necessary for the utility to

be properly positioned for competition. These include:

- Mechanisms for accelerated cost recovery of regulatory assets to reduce or eliminate the threat of stranded investment and possible write-offs;
- Performance based ratemaking;
- Pricing flexibility for all customer classes;
- Approval of appropriate corporate structures;
- Controlled flexibility under the Affiliated Interest Rules; and
- Tariff flexibility to enhance the ability of the utility to compete for new load.

As previously stated, TEP is in favor of competition and believes that customers will ultimately demand a competitive electric utility industry. However, for this to happen, the utilities and the Commission must continue to work together to ensure that the transition occurs efficiently and equitably as possible.

TEP appreciates the opportunity to provide these comments and looks forward to working with the Commission and Staff to achieve these goals.